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The impact of Mitchell judgement on purchases of immovable property from an insolvent estate

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In a recent judgement, of *City Tshwane Metropolitan Municipality v PJ Mitchell* (38/2015) (2015) ZASCA, the Supreme Court of Appeal ruled that a hypothec created by section 118(3) of the Municipal Systems Act 32, 2000 in favour of a municipality over immovable property for outstanding municipal debt is not extinguished by a sale in execution and subsequent transfer of the property. Municipal debt includes; municipal service fees, surcharges on fees, property rates and other municipal taxes and levies incurred in relation to the property.

INTRODUCTION

The purchaser was held liable for the municipal debt relating to the property, dating back 30 years, as the court held that the right of the municipality to perfect its security in terms of the section 118(3) hypothec can be enforced at any time before the debt prescribes. The immovable property in question was not sold pursuant to the insolvent circumstances of the seller.

An interesting question which arises from the *Mitchell* judgment is whether the purchaser of an immovable property realized from an insolvent estate is exposed to the risks created by the judgment to the same extent as a property buyer in circumstances where the seller is solvent.

THE INSOLVENCY ACT

Section 89 of the Insolvency Act 24, 1936 (the "**Act**") provides that "tax", for the purposes of that section, in relation to immovable property means, "*any amount payable periodically in respect of that property to the State or for the benefit of a provincial administration or to a body established by or under the authority of any law in discharge of a liability to make such periodical payments, if that liability is an incident of the ownership of that property*", and stipulates that any such tax "*which is or will become due on the immovable property being sold in respect of any period not exceeding two years immediately preceding the date of the sequestration of the estate in question and in respect of the period from that date to the date of the transfer of that property by the trustee of that estate, with any interest or penalty which may be due on the said tax in respect of any such period, shall form part of the costs of realization*"

Section 89(1) provides that those costs of realization shall be paid by those creditors, *pro rata*, who have proved their claims and who would have been entitled, in priority to other persons, to payment of their claims out of those proceeds if they had been sufficient to cover the said cost and those claims. Therefore, the municipal debt (of the nature referred to in the *Mitchell* judgment) in respect of the two year period preceding the date of sequestration of the relevant estate, and the period between the sequestration and the transfer of the property, would be classified as "tax", and accordingly, as a "realization cost", with the consequence that any creditor who has proved a claim against the estate will be held liable for that municipal debt, to the extent that the proceeds of the sale of the property were not sufficient to cover that debt.

A creditor may prove a claim against an insolvent estate in terms of section 44(1) of the Act, which provides that –

"Any person or the representative of any person who has a liquidated claim against an insolvent estate, the cause of which arose before the sequestration of that estate, may, at any time before the final distribution of that estate in terms of section one hundred and thirteen, but subject to the provisions of section one hundred and four, prove that claim in the manner hereinafter provided: Provided that no claim shall be proved against an estate after the expiration of a period of three months as from the conclusion of the second meeting of creditors of the estate, except with leave of the Court or the Master, and on payment of such sum to cover the cost or any part thereof, occasioned by the late proof of the claim, as the Court or Master may direct."

Further, section 104(1) of the Act provides that –

"...a creditor of an insolvent estate who has not proved a claim against that estate before the date upon which the trustee of that estate submitted to the Master a plan of distribution in that estate, shall not be entitled to share in the distribution of assets brought up for distribution in that plan: Provided that the Master may, at any time before the confirmation of the said plan permit any such creditor who has proved his claim after the said date to share in the distribution of the said assets, if the Master is satisfied that the creditor has a reasonable excuse for the delay in proving his claim."

The cumulative effects of the abovementioned sections of the Act are that, to the extent that the municipality has proved its claim against the insolvent estate for the municipal debt relating to the property in respect of the two year period preceding the date of sequestration of the relevant estate, and the period between the sequestration and the transfer of the property, and –

- the proceeds of the sale of the property were not sufficient to cover that claim, the municipality will be liable for that municipal debt; or
- the proceeds of the sale of the property were sufficient to cover that claim, then the municipality's claim will be settled out of such proceeds.[1]

To the extent that the municipality has not proved its claim against the insolvent estate for any outstanding municipal debt relating to that property (which is not limited to that municipal debt accrued over the period of two years preceding the sequestration) within three months from the conclusion of the second meeting of creditors of the estate, and before the date upon which the trustee of that estate submitted to the Master a plan of distribution in that estate, then the municipality shall not be entitled to share in the distribution of assets brought up for distribution in that plan, except with leave of the Court or the Master.

In circumstances where the municipality has not proved its claim within the aforementioned prescribed time limits, and condonation for that delay is not granted by the Master or the Court, then it appears that the municipality will not have a claim for outstanding municipal debt against the new owner of the property.

Further, section 95(2) of the Act creates a right for the trustee to cause the proceeds of the sale to be kept in the Guardian's Fund, should he suspect that, *inter alia*, there are outstanding municipal debts in relation thereto. If the trustee does so deposit the proceeds with the Master for safekeeping in the Guardian's Fund as aforesaid, it would appear that the creditor (being the municipality in this case) is only entitled to satisfaction of its relevant claim if it makes an application to the Master within one year in accordance with the section. This provision may minimise the risk for the purchaser in that the municipality's claim to any such proceeds set aside in terms of this section would expire after a year.

CONCLUSION

Therefore, in circumstances where an immovable property in question is sold out of an insolvent estate, the risks created by the *Mitchell* judgment for the purchaser are at best mitigated, but not excluded, by the aforementioned sections of the Insolvency Act.



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